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Mr. Chairman and Members of the Committee:

I welcome the opportunity to be here today and applaud you for bringing together individuals from the aviation industry as well as outside experts to undertake an open and serious discussion about a matter important to all of us--competition in aviation across the United States.

When Secretary Slater called for a dialogue on airline competition, he knew that Congress, and this Committee in particular, Mr. Chairman, would be an essential voice. I am pleased to be a participant in your discussion today.

We have seen over the years that we accomplish far more in aviation by engaging in constructive give-and-take and by working together. Witness the birth of airline deregulation itself. That landmark event in the history of domestic air travel in the United States would not have come about without the concerted efforts of many--inside government and out.

Government, airline management, and labor worked together successfully to overcome the recession that gripped the industry at the time President Clinton took office. And we saw recently, a real safety advance for all air travelers resulted when the FAA collaborated with airlines, manufacturers, and labor to design a focused safety agenda for the aviation industry.

SUCCESS OF DEREGULATION

This same cooperative spirit can pay equal or greater dividends as we grapple with today's issue--forging appropriate measures to preserve and foster a competitive climate in the air transportation industry. Let no one mistake our view--deregulation of domestic air travel in 1978 was one of Congress' earliest and best efforts to bring powerful economic forces to bear on behalf of the traveler, the shipper, and the airline industry itself. This view is widely shared, and is confirmed by all of our studies at the Department.

Deregulation in the United States has expanded the pie for everyone and for the benefit of everyone. U.S. airlines carry about 270 million more passengers a year than under regulation. On average, domestic consumers pay a third less (in constant dollars) than they did twenty years ago. And, airline operating

profits are also at record levels -- totaling $20 billion in the last three years.

Airline deregulation works when the airlines compete fairly with each other. Consumers benefit when the airlines compete because, to win business, they have to offer more attractive service and fares. In fact, one regional airline -- Southwest -- has established itself as one of the nation's larger and stronger airlines by offering consumers both low fares and good service.

In response to deregulation, the major airlines developed hub-and-spoke networks and have created twenty hub airports around the country. Hubbing creates advantages for many travelers, since it gives travelers at the hub cities many more flights and enables airlines to offer more service in markets without enough traffic to sustain non-stop service. On the other hand, hubbing has the disadvantage of making effective competition in the hub's local markets very difficult, thereby allowing the hub airline to charge higher fares in such markets. A hub airline has competitive advantages in those markets because it operates the most flights and can offer travelers a more attractive frequent flyer program and travel agencies more attractive incentive commission programs. As a result, most hub markets have little competition, and the passengers in those markets pay relatively high fares. New service by a low-fare airline is likely to be the only way that many hub markets will ever benefit from competitive airline service.

A low-cost airline's entry into a hub market can produce enormous consumer benefits. For example, the Department's April 1996 study of low-cost airlines examined the effects of the low-fare service offered by Morris Air and Southwest, which acquired Morris, in a number of Salt Lake City markets. The traffic in those markets tripled, while the average fares in those markets dropped by about fifty percent when fares in other Salt Lake City markets were increasing somewhat. As a result, by late 1995 the average fares in the markets served by Morris and Southwest were only one-third the level of fares in other Salt Lake City markets.

A COMPETITION PROBLEM

In the last few years, however, the Department has received an increasing number of complaints by smaller airlines that the largest airlines are using unfair tactics to keep them from getting a foothold in many markets at hub airports. Others have echoed these complaints -- Members of Congress, local communities, travel agencies, and business and leisure travelers. Let me give you one example as a concrete idea of what we have heard and what we have found.

When a new entrant started operation in one major city-pair market, the dominant hub carrier initially did not slash its fares and increase capacity in response to the new service. However, after a few months the hub carrier

matched the newly offered $49 one-way fare and added more seats. Before this move, thirty percent of the hub carrier traffic -- about 13,000 passengers -- paid fares of $325 to $350, while less than 1,500 passengers paid fares of $75 or less, during a three-month period. After the hub carrier dropped its fares and increased capacity, it carried almost 50,000 passengers who paid no more than $75 and less than 1,000 passengers who paid fares of $325 to $350. In a three-month period after the new entrant left the market, the hub carrier sold less than 1,000 seats at fares under $75, carried only about 3,000 passengers paying fares of $325 to $350, but carried over 12,000 passengers paying fares of $350 to $375.

Mr. Chairman, we have not moved precipitously in response to this type of complaint. The Department undertook a detailed analysis of the complaints brought to us. Our airline experts spent countless hours studying extensive airline company records, identifying patterns of behavior, and analyzing industry data. In developing our proposed policy, we conferred with expert staffs at the Department of Justice and the Federal Trade Commission. As a result of these efforts, we are concerned that unfair exclusionary practices by some major network airlines are preventing needed competition at hub airports, effectively denying more reasonable fares and affordable access to tens of millions of potential passengers across the country.

Under the statutory mandates Congress has enacted to preserve and foster competition in air travel, we concluded that we are obligated to act. We considered enforcement action. But in the end, we concluded (in fact at the suggestion of some of the airlines) that the best approach was to set forth policy guidance on what, in the Department's view, constitutes unfair exclusionary conduct warranting Departmental action.

Reviewing the continuum of carrier behavior over several years, we have shaped a policy that targets only the most egregious conduct--when a combination of factors occur in carrier behavior that cannot be adequately explained as good economics. We will apply a final policy prospectively, so that carriers are fully aware in advance of what conduct will be found to be unfair exclusionary conduct. And the Secretary determined that we would put out for public comment a <u>proposed</u> policy so that we could engage in the kind of dialogue we are having here today. We have no intention of reregulating the airline industry, as some have charged. Rather, we want to assure that effective competition--which is the linchpin to the success of deregulation and the benefits it brings to consumers--is preserved.

PROPOSED ENFORCEMENT POLICY

Our proposed policy statement identifies the behavior that we will consider to be an unfair exclusionary practice. If, in response to new entry into one of its hub

markets, a major carrier pursues a strategy of price cuts and capacity increases that either (1) sacrifices more revenue than all of the new entrant's capacity could have diverted from it or (2) results in substantially worse short-term operating results than would a reasonable alternative strategy for competing with the new entrant, we propose to find this unlawful. Any strategy this costly in the short term is economically rational for the major carrier only if it forces the new entrant from the market, after which it can readily recoup the revenues sacrificed to achieve this end.

It's one thing for an established airline to match the prices of a competitor's new service. That is legitimate competition. It's another thing entirely for an airline to not only match that price, but to also sell ten times as many seats as the new entrant at the low fare, thereby ensuring that both the new entrant and the established airline will lose money or forego profits . . . but only until the new entrant is driven from the market. Then, the established carrier slashes the amount of service, raises fares, and recoups its losses or lost profits -- all at the cost of much higher prices to the consumer. This, under our policy, is unfair competition.

To provide guidance we have set forth three types of obviously suspect responses to new entry that will normally trigger an enforcement proceeding to determine whether a violation has occurred:

(1) when the major carrier adds capacity and sells such a large number of seats at very low fares that the resulting self-diversion of revenue results in lower local revenue than would a reasonable alternative response;

(2) when the major carrier carries more local passengers at the new entrant's low fares than the total number of seats that the new entrant offers, resulting, through self-diversion, in lower local revenue than would a reasonable alternative response; and

(3) when the major carrier carries more local passengers at the new entrant's low fares than the new entrant does, again resulting, through self-diversion, in lower local revenue than would a reasonable alternative response.

To summarize, before we undertake any formal investigation, at a minimum we will ask these three questions: first, did the major carrier cut its fares to effectively match those of the new entrant; second, did the major carrier also significantly increase the capacity it offered at low fares; and third, did the decrease in fares coupled with the increase in low-fare capacity result in considerably lower local revenue than the major carrier would have realized under a reasonable alternative strategy.

We do not wish to stifle legitimate competitive responses to new entry, which provide the lasting benefits to consumers that deregulation should bring. We recognize that this can involve a delicate balance, and that is one of the reasons we are eager to get the views of all interested parties. We are not proposing in this policy to protect competitors, but to promote competition. We are carrying out our statutory responsibilities to ensure that if a low-fare airline's entry into a major carrier's hub markets fails, it fails on the merits, not due to unfair methods of competition.

STATUTORY AUTHORITY

Some have contended that the Department has exceeded its authority in issuing the proposed enforcement policy. It is our view that an enforcement policy of this kind is a proper use of our statutory authority to define and prohibit unfair methods of competition and a proper discharge of our statutory mandate to promote competition.

Section 41712 of our organic statute (formerly section 411) tasks the Secretary, when he or she considers it to be in the public interest, to "decide whether an air carrier. . . is engaged in an unfair or deceptive practice or an unfair method of competition" and to take appropriate action to end any abuse. Nothing in the terms of that section excludes any type of unfair competitive conduct from its reach.

In addition, other provisions of the statute make it clear that Congress expected us to take action when major airlines engage in conduct that unreasonably threatens competition in airline markets. The statute's policy section specifically directs the Secretary, in carrying out his responsibilities, to consider that the public interest requires "preventing unfair, deceptive, predatory, or anticompetitive practices". The statute also directs him or her to consider in the public interest "avoiding unreasonable industry concentration, excessive market domination, monopoly powers, and other conditions that would tend to allow [a carrier] unreasonably to increase prices, reduce services, or exclude competition . . . ." 49 U.S.C. 40101(a)(9) and (13).

Furthermore, Congress deemed our exercise of this authority to prevent unfair methods of competition essential for the success of deregulation. While Congress eliminated many of the other regulatory provisions governing the airline industry as part of deregulation, Congress' review of the operation of deregulation in 1984 caused it to conclude that the statute must maintain our authority to prohibit unfair methods of competition. And it did not carve out any area of airline operations from the scope of that authority. As the House committee stated, H.R. Rep. No. 98-793, 98th Cong., 2d Sess. (1984) at 4-5:

> There is also a strong need to preserve the Board's authority under

> Section 411 to ensure fair competition in air transportation . . . . Although the airline industry has been deregulated, this does not mean that there are no limits to competitive practices. As is the case with all industries, carriers must not engage in practices which would destroy the framework under which fair competition operates. Air carriers are prohibited, as are firms in other industries, from practices which are inconsistent with the antitrust laws or the somewhat broader prohibitions of Section 411 of the Federal Aviation Act (corresponding to Section 5 of the Federal Trade Commission Act) against unfair competitive practices.

As the House recognized then, and as the courts have held, the Department's authority to prohibit unfair methods of competition allows us to prohibit both conduct that violates the antitrust laws and anticompetitive conduct that does not violate the antitrust laws. Congress gave us that authority (and the FTC comparable authority over other industries) because Congress believed that businesses could engage in practices that unreasonably and unfairly threatened competition without violating the antitrust laws and that the Department should have the power to prohibit such conduct.

The unfair exclusionary behavior we address in our proposed policy is analogous to, and may in some cases amount to, predation within the meaning of the federal antitrust laws. A major airline's use of large fare cuts and capacity increases and sacrifice of revenues in the short run in order to eliminate competition in hub markets, after which it can cut capacity and raise fares to at least their original levels and recoup losses or lost profits, closely resembles conduct prohibited by the Sherman Act. In any event, the authority given us to prohibit unfair methods of competition is not confined to practices that violate the antitrust laws.

In sum, our proposed enforcement policy comes within the language of our statute, is consistent with the courts' interpretation of the scope of our statutory authority and, most importantly, carries out Congress' determination that the success of deregulation requires us to preserve competition and stop anticompetitive behavior.

As Secretary Slater has said:

> Our responsibility at the Department of Transportation is to ensure that every airline -- large or small, new or established -- has the opportunity to compete freely. That is what deregulation is supposed to be all about -- a fair chance to compete.

MERGERS AND ALLIANCES

You have asked me to address another issue affecting competition in the aviation industry --the possible competitive implications of increased concentration in the airline industry.

Let me first note that the recently-announced alliance between Northwest and Continental represents the first significant combination among domestic airlines in the past several years. There was a wave of mergers in the airline industry in the 1980's but no major domestic airline transactions in recent years.

We have heard concerns that the recently announced Northwest-Continental transaction will increase concentration in the domestic airline industry. We believe that we and the Justice Department have the tools to determine whether such a transaction would lead to a significant loss of competition.

The two airlines' alliance is subject to review by the Justice Department under the antitrust laws, and the Justice Department has begun a review of the transaction to see whether it complies with them. If the Justice Department finds that the transaction should be prohibited or modified to avoid a substantial reduction in competition, I am sure that they will take the necessary steps to achieve that result. We have begun consulting with the Justice Department's staff on the transaction and plan to offer them our views on its likely competitive consequences.

Although the Justice Department is responsible for challenging airline mergers and acquisitions that would violate the antitrust laws, this Department has the authority to review those transactions insofar as they involve the transfer of international route authority. As a general proposition, we will deny such transfers if they would reduce competition or be contrary to our international aviation policy.

CONCLUSION

Mr. Chairman and members of the Committee, as Secretary Slater has said, "As the interstate was to the second-half of the twentieth century, air travel will be to the first-half of the twenty-first century." The Department of Transportation is working hard to preserve the benefits of competition and to protect the interests of consumers. This Administration is committed to ensuring competition in the domestic -- and international -- airline business. That is why we have worked so hard to secure 29 Open Skies agreements; we have issued our proposed competition policy; we have granted 85 slot exemptions to provide valuable new air serve and competition. And shortly, we will be undertaking a review into whether new airlines have been thwarted in various markets due to an inability to obtain adequate airport facilities on reasonable terms. We look forward to

working with Congress to ensure that the aviation system continues to grow and that consumers continue to benefit.

Thank you Mr. Chairman. This completes my prepared statement, and I would be pleased to respond to your questions and those of the Committee.